"Whatever may be the case in other matters, compromise in arithmetic seems singularly out of place." – C. H. Douglas

It is common knowledge that the distinctive characteristic of the Modern productive system is the sub-division of labour and process. This sub-division results, without any reasonable doubt, in making it possible to utilise mechanical power, machine tools and specialised factories, all of which are financially represented by what is called overhead charges.

Consider the production of an article which has ten processes, and imagine that the physical material on which these processes are carried out remains in each of ten separate costless factories for one month. Imagine also that the moment that this material enters a factory a loan is obtained from a bank to finance the cost of the operations which are performed on it.

Now imagine, what is of course never the case, that the workers employed in the first factory bought the product of the first process with the wages and salaries, i.e., £10, which were distributed to them. They would have the product of the first factory, and would have no money, their money being repaid to the bank through their employers. We will suppose that they sell at cost the product of the first factory, to the second factory, which borrows the £10 from the bank. They have no goods but they have again £10. The goods, however, exist. They are in the second factory and have a ticket attached to them which says they are worth £10 more than when they went into the first factory. The bank now lends a further bank credit of £10 to the second factory which pays it out in wages and salaries. The second factory owes the bank £20. The workmen again spend the whole of their wages and salaries in purchasing the product. We will suppose that they are the original men of No. 1 factory who moved on to the second factory with the product. Therefore they will be able again to buy the product for £20. The bank will be repaid out of the purchase money of the workmen.

At every stage of the process there exists three "assets". A debt owing to the bank, a purchasing power that will either liquidate the bank debt, or it will transfer the goods. It will clearly not do both. It is impossible for the repayment of a loan to a bank to take place other than through the purchase of goods (deflation) without dislocating the financial system.

Consider the nature of these assets:

**The bank debt**, which is shown in the bank's accounts as an asset has one attribute which distinguishes it from the other two. The initiative of a liquidation of it probably rests with the bank and not with anyone else, because it is a "loan".

**The goods produced**, which may be regarded as a second asset, require the consent of a purchaser before they can be transferred. The third asset, the **purchasing power distributed** will either transfer goods or liquidate the bank debt.

Assets No. 1 and No. 3 cancel each other on cross-transfer. Asset No. 2 does not so cancel.

Now suppose at any stage of the proceedings asset No. 3 is used to buy or cancel asset No. 1; then clearly there is a disparity between the figure value of asset No. 2, which is not affected by this transaction and the figure value of the other two assets, *i.e.*, the bank debt and the purchasing power.

This is exactly what happens when any portion of the loans concerned in any stage of the production of an article is repaid to a bank before the articles, into the cost of which they enter, has finally and irrevocably been sold to its ultimate consumer. In order either to resell it (in addition to normal trade in new articles) or to use it in such a way that it forms a cost in production, a fresh loan has to be granted upon it.

Proceeding with our hypothetical example we finally arrive at the end of stage number ten when the following condition exists. The bank has lent to the factory representatives £100, *i.e.*, £100 to buy the product of the preceding factories, and £10 to pay the wages of the final stages. The employees have £90 saved as a result of their work in the preceding nine factories. They get £10 for their final month's work which gives them £100, and the product has £100 cost price value upon it. Reams of ingenious mathematics have been evolved to prove this point; but it will, I think, be agreed that they are largely unnecessary.

We will suppose that these workmen again buy the final product with the £100 which the factory representatives then use to repay the bank, and therefore the £100 and the bank loan cancel each other and there is nothing left to show for the transaction.
except an article which has £100 cost price value attached to it and there is nothing anywhere to form a contra account to this. If it is a "consumable" product, it disappears, if "capital" goods, it does not.

Let us call the product of the whole of this series of operations B, and let us suppose that the workmen of the original transaction decide to set up in business for themselves, B forming the plant of their business. Again there are ten operations in their processes of production, each of them taking a month and each of them requiring £10 for wages and salaries. They finance themselves from a bank in exactly the same way as before, but we will call the £10 that they pay in wages to a new set of workmen, A. It will at once be seen that a new factor has entered into the process. The workmen of factory No. 1 get £10 in wages but they cannot buy the product of their month's work even if they wished to do so, because the factory contains a portion of plant B which interest, depreciation and obsolescence has to be charged. These we will call the overhead charges of the factory and we will imagine them to be 20 per cent., which is an insignificant figure for overhead charges, but it means that the workmen, instead of being able to buy the product of their month's work for £10, would have to pay £12, and there is not £12 in existence under the conditions we have laid down. There is a plant B which has a price value on it, but that price value has no available purchasing power in a negotiable form set over against it anywhere, and the only place from which it can be obtained is by the creation of something which functions as money. If we follow this process through to the end, imagining that the workmen of the second series of factory operations save all their money and each factory adds 20 per cent. overhead charges, we arrive at the position that there is an ultimate product for sale with a price value of £120 upon it, a purchasing power in the hands of the workmen of £100 and a debt for financing the second series of processes to the bank of £100.

Note particularly that the question of profit has not entered into any of these transactions at all. In every case the factory representatives have merely endeavoured to re-coup themselves in money for charges which at some time or another have been incurred. But the vital fact is that this money does not exist. Only the price value exists; the money has been re-cancelled by the repayment of bank loans.

The matter may be stated thus: When a factory adds, as it always does add, certain "costs" to its "prices" for the use of its buildings, tools, and intangible assets, it creates a price value but does not create any purchasing power. The only new purchasing power which is distributed is that which did not exist before, i.e., the bank loan. Therefore we can say "The rate of flow of purchasing power is the rate of flow of money or credit being distributed through wages or salaries (A), but the rate of flow of prices is money distributed in direct costs, plus charges created in respect of money which does not exist. Consequently, A will not purchase A plus B (vide Credit-Power and Democracy, page 22).

Note that this theorem has nothing whatever to do with gold standards, inflation, deflation, or even bank policy. It depends fundamentally on the problem of the beneficial ownership of credit and it would, for instance, be wholly unaffected by the Nationalisation of Banks.

It is, I believe, the vital theorem on which turns the immediate future of civilisation. Before dealing with this aspect, however, it is necessary to consider the complications introduced by the fact that the public does not buy intermediate products; and the related problems of inflation and deflation.

The division into stages of the typical production process enables it to be seen that the earlier stages of production become overhead charges (for the later stages) at the moment that the money which financed them is returned to the point from which it started. A consideration of this proposition is sufficient to show that there is no essential difference between financing industry by the creation of a bank credit and the financing of it by the provision of working capital out of the "savings" by an individual. The essence of the matter is that each time the "money" makes a complete cycle, it leaves a set of price values equal to itself, and consequently, if, let us say, £100 is used to pay wages and salaries for the production of a lathe and the lathe is bought by the people who make it, the money thus returning to the source of the finance and again paid out to make another lathe, there will be two lathes in existence valued at £100 each and only £100 in money in existence and even that £100 will not be available for consumption purposes.

If every employee endeavoured to buy the product of his labour at the end of short fixed periods, the system would be exposed at once. But two factors arise to prevent this. The first of these is that the individual is a consuming machine and requires constant purchases to meet his ends; and further that capital or intermediate production is of no value to him. The effect of this is to concentrate all but a very small percentage of the total wages and salaries distributed in respect, both of intermediate and final processes, on the purchase of ultimate products. Now—and this is important—it will be seen on careful consideration that if there is not enough money available to buy ultimate products (and we have already ascertained that the money required to buy a definite amount of ultimate products is not available as the result of the distribution of money during the intermediate processes leading to the production of these products) the gap can be bridged temporarily by producing more intermediate products or capital goods which the ultimate consumer has no need for and does not in fact wish to buy. It is in fact a modern version of Charles Lamb's famous story "Roast Pig". But ignoring for the moment the absurdity of making undesired articles in order to obtain money with which to buy articles which are desired and are already produced, certain serious difficulties are created, even from the financial point of view by this process.
In the first place, these capital goods have to be sold to someone. They form a reservoir of forced exports. They must, as intermediate products, enter somehow into the price of subsequent ultimate products and they produce a position of most unstable equilibrium, since the life of capital goods is in general longer than that of consumable goods, or ultimate products, and yet in order to meet the requirements for money to buy the consumable goods, the rate of production of capital goods must be continuously increased.

Even straining practicability so far as to allow, however, that it is feasible to increase the wages and salaries distributed for the production of capital goods to the exact amount of consumable goods or ultimate products, it will be recognised that if these goods remain at home the money paid on them has to be recovered from the public in the price of future consumable goods, *i.e.*, the purchasing power distributed in respect of them is simply a mortgage granted on future ultimate production.

If these capital goods are exported in return for *money* they are, from the energy point of view a dead loss. Exactly the same result could have been obtained by writing a cheque for them. This has been emphasised if emphasis were needed, by the amazing manoeuvres in regard to foreign loans which have been the feature of the post-war years, the process consisting of a wild scramble to lend money abroad in order that the goods might be taken out of the country. If they are exported in return for goods, then still there is no *money* in the country with which to buy these imported goods.

The position is still further complicated by the fact that while a cost forms the lower limit of price, the upper limit of price is only limited by what people are willing or forced to pay, up to the amount of money which they possess. The amount of money which the great majority of people possess is considerably less than is necessary to enable them to satisfy their requirements for goods. As a consequence any increase in the amount of money which comes into their possession is almost immediately reflected in an increase in their purchases of ultimate products, and this is very shortly followed by an increase in the price of such products as a result of what is somewhat absurdly known as profiteering.

Such an increase in money distributed is provided by any acceleration in the rate of distribution of money for intermediate products, *e.g.* machinery, factories, etc. This increase of money, accompanied by a rise in prices, is the only intelligible meaning which can be attached to the word inflation. Deflation, the opposite of this, is a fall in the amount of money accompanied by a fall in prices and it must be obvious that if these words are used with any regard to consistent meaning, neither of them affects permanently the relation between prices and money issues, and consequently nothing intermediate between the two extremes of them, such as for instance, the much advertised policy of stabilisation, affects the relation.

This enables a proposition of the first magnitude to be stated.

In the modern world, run on the orthodox financial system, there is only one method at the present time by which fresh money can reach the individual, and that is through the medium of wages and salaries. The wages and salaries form only one part of the selling price of any article. **The remainder of this selling price is a creation of price values unaccompanied by a creation of money or purchasing power.** Even the creation of a credit to a producer equal to the amount of his overhead charges, would not overcome this difficulty. He is not the buyer. There are only two possible methods by which this difficulty can be overcome, assuming the retention of any money system at all. The first is to make a grant of money to the buyer equal to the difference between wages and salary costs and total selling price, and this method seems to present insuperable difficulties in regard to price fixing. And the second method is to sell at a properly regulated fraction of cost and make up the financial difference to the producing organisation.

Either of these proposals is an assertion of the fact that the beneficial ownership of credit vests in the individual, the buyer or consumer, although it makes no assertion as to its trusteeship, which is the point which is raised in discussions as to the private administration or nationalisation of banking. Unless I am much mistaken the disposition to consider the voluntary relinquishment of the monopoly of credit, with all its immense implications, is still in the most embryonic form in the minds of bankers, even if it can be imagined to exist at all.

For instance, it seems possible that Mr. McKenna's very able expositions of the technique by means of which banks create all but an insignificant fraction of the money of a country, which have caused his confreres some concern, might be interpreted as a most admirably conceived first step to the legalisation of a monopoly which has been achieved at the expense of public ignorance and might be endangered by general enlightenment. I hope I am wrong in this belief, because if I am not, there is little doubt that rivers of blood will flow over this matter before many years have passed.

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